State of Oklahoma
Incentive Evaluation Commission
Quality Jobs Investment Program Evaluation

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Key Findings and Recommendations

Overview

The Quality Jobs Investment Program (Program) was created in 1994. It authorizes the Oklahoma Development Finance Authority (ODFA) to provide funding to investment enterprises which subsequently invest in businesses relocating or expanding in Oklahoma. The Program is funded by bond issuances secured by the State's Credit Enhancement Reserve Fund. The Program is authorized to issue up to $40 million in bonds to fund investments, but it has only issued one $9.9 million 1996 series of variable rate bonds.

The Program's latest investment was made in 2007. The poor performance of the investments made by the Program has led to a declining fund balance and income levels that cannot cover the interest payments on the bonds that initially financed the Program. ODFA no longer views this Program as a useful tool for economic development and has no plans to make investments at any time in the future. The initial goals of the Program are currently being pursued by more recent State economic development investment efforts, including the Oklahoma Seed Capital Fund and the Technology Business Finance Program.

Recommendation: Based on its analysis of available data, the project team recommends repealing the program.

Key Findings Related to Established Criteria for Evaluation

The Program has a negative balance due to poor investment performance. As of June 30, 2017, the net balance of the Program was -$3.4 million. This deficit is likely to grow as the return on its investments have not been sufficient to cover annual interest payments on bonds issued to fund the Program.

No Program investments have been made since 2007. The latest investment, totaling $1.15 million, provided a compound return on investment of 0.8 percent. The ODFA has no plans to make further investments using the Program.

The variable interest rate on the outstanding bonds creates the potential for the costs of the Program to increase in the future. The interest rate was last adjusted in 2008, when it declined from 5.36 percent to 2.5 percent. This change decreased annual interest payments from $535,696 to $249,975. However, based on market conditions, the interest rate may rise in the near future (and continue to fluctuate), as these bonds do not mature until 2031. ODFA intends to use its assets to the extent possible to meet its obligations. However, if ODFA is unable to meet its obligation at the maturity date, the obligation may be met by issuing general obligation bonds from the Credit Enhancement Reserve Fund.

At the maturity date of the bonds, the Program is projected to have a balance of -$6.2 million. With no active investments, the only income the fund will receive over the rest of the bonds duration will be from cash management interest equal to about $35,000 per year. This interest is insufficient to cover the current annual debt service of $249,975.

Introduction

Incentive Evaluation Commission Process Overview

In 2015, HB2182 established the Oklahoma Incentive Evaluation Commission (the Commission). It requires the Commission to conduct evaluations of all qualified state incentives over a four-year timeframe. The law also provides that criteria specific to each incentive be used for the evaluation. The first set of 11 evaluations were conducted in 2016, and an additional 12 were conducted in 2017.

The Quality Jobs Investment Program is one of 11 incentives scheduled for review by the Commission in 2018. Based on this evaluation and their collective judgment, the Commission will make recommendations to the Governor and the State Legislature related to this incentive.

Quality Jobs Investment Program Incentive Background

The Quality Jobs Investment Program (Program) was created in 1994. It authorizes the Oklahoma Development Finance Authority (ODFA) to provide funding to an investment enterprise that invests in businesses relocating or expanding in Oklahoma. The program is funded by bond issuances secured by the Credit Enhancement Reserve Fund.

Criteria for Evaluation

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation. In the case of this program, its statute describes its goal as to create "**a more comprehensive and efficient public and private financing infrastructure for businesses relocating or expanding in this state**."[1]

To assist in a determination of program effectiveness, the Incentive Evaluation Commission has adopted the following criteria:

- History of use of the program
- Investment outcomes – businesses created or expanded, jobs and payroll as a result
- History of returns on investments

The criteria focus on what are generally considered key goals of incentive programs, in this case, businesses created or expanded and additional jobs and payroll that result. Ultimately, incentive programs have to weigh both the benefits (outcomes related to achieving policy goals and objectives) and the costs, and that is also a criterion for evaluation (State return on investment). These will be discussed throughout the balance of the evaluation.

[1] 74 O.S. § 70 5062.8a

Incentive Usage and Administration

Program Administration

The Quality Jobs Investment Program (Program) is administered by the Oklahoma Development Finance Authority (ODFA). The program's establishing statute authorizes ODFA to attract private investment capital to qualified "investment enterprises" by directly investing in or providing guarantees to them. Selected investment enterprises must use ODFA funds to invest in relocating or expanding businesses in Oklahoma. These enterprises may be a corporation, limited partnership, or other business entity, including Small Business Investment Companies. All investments made by the Program must be matched at least equally by private sector investment.

The statute outlines the primary activities of the Program as the following:

1. To utilize private and public resources to build a more comprehensive and efficient public and private financing infrastructure for businesses relocating or expanding in the this state, and not solely for direct investment, lending or guarantees;
2. To act as an investor, insurer or guarantor of business capital and debt financing in the this state;
3. To inform business entities of available public and private capital sources and how to access those sources; and
4. To primarily function as a wholesaler of business capital and credit and rely principally on private institutions to serve as retailers of the business capital and credit market.

The Legislature allocated a portion of the Credit Enhancement Reserve Fund (CERF) to assist in the issuance of bonds to fund the Program. The ODFA is legally authorized to issue general obligation bonds of up to $100 million collateralized by this fund to secure favorable financing for economic development purposes. CERF improves the creditworthiness of debtors because the Legislature is able to make appropriations in order to pay any outstanding debt service, if needed, for certain purposes. Of the fund, $40 million is reserved for the QJIP.

In 1996, the ODFA issued $9.9 million in bonds in order to fund investments made through the Program. This is the total amount of bonds ever issued for the program. The bonds are backed by a CERF guarantee and payable from:

1. Program investment returns:
2. Funds in the ODFA's Program fund:
3. The Credit Enhancement Reserve Fund guarantee.

The bonds were originally set to mature in 2006, but ODFA signed an agreement that year to extend the maturity date to April 1, 2031. The bonds' interest rate is variable and based on the Oklahoma Industrial Finance Authority's cost of funds. This interest rate significantly impacts the interest payments made on the bonds. The interest rate was last adjusted in 2008, when it declined from 5.36 percent to 2.50 percent. This change decreased annual interest payments from $535,696 to $249,975.

Use of the Program

The Program has not been used since 2007, when the ODFA made a $1.25 million commitment to the Oklahoma Seed Capital Fund, using Program funds. The Oklahoma Seed Capital Fund is operated by i2E, a private not-for-profit corporation, and it invests in innovative start-ups in the State. The capital contributed by ODFA made up about one-fifth of the $5.33 million Seed Capital Fund's 2007 series of funding.

With this series of funding, i2E invested in eight Oklahoma companies through the Seed Capital Fund. The following table provides the funding breakout. According to i2E's latest survey results, companies receiving funding reported a total of 40 full-time employees and over $3.4 million in payroll.

Table 1: Oklahoma Seed Capital Fund Series 2007-1 Portfolio

Company Name	Funding Amount
Altheus Therapeutics, Inc.	$1,415,033
eMotion Media	$716,666
Exerbotics, LLC	$651,316
Tetherex Pharmaceuticals	$570,532
Alkami Technology, Inc.	$500,000
Credit Point Software, Inc.	$500,000
Lifetone Technology	$492,160
Selexys Pharmaceuticals	$487,929
Total	**$5,333,636**

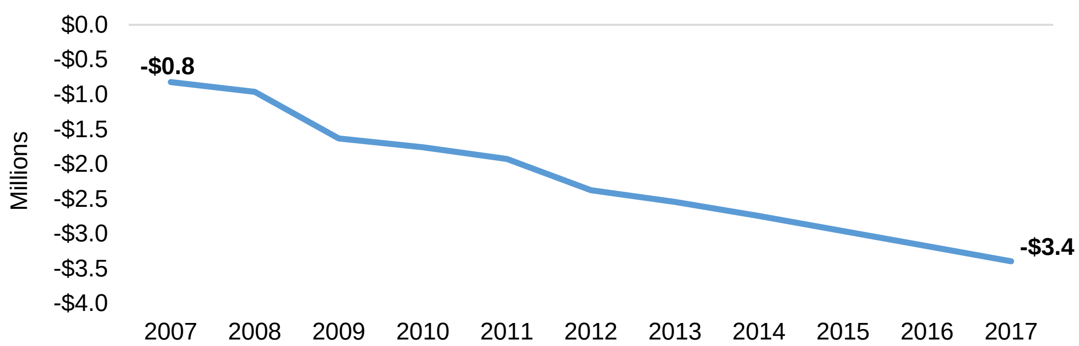
Source: Oklahoma Development Finance Authority

In 2016, ODFA received repayment of its contributed funds. The Seed Capital Fund used $1.15 million of the $1.25 million in committed capital. The repayment received by ODFA totaled $1.24 million, for an investment return of $87,777. This represents a compound annual rate of return of 0.8 percent.

Since this investment in 2007, QJIP funds have not been used. The Program currently has no active investments, and the ODFA does not plan to make use of the program at any time in the future.

As a result of poor return on investments made by the program, the Program has been operating at a net loss. As of June 30, 2017, the net balance of the Program was -$3.39 million. The following chart shows the ending fund balance over time.

Figure 1: Quality Jobs Investment Program Ending Net Position, FY 2007 through FY 2017



Source: Oklahoma Development Finance Authority

Since 2016, when the $87,777 return on investment was collected from the Oklahoma Seed Capital fund, the only investment income received by the Program has been interest earnings from cash management. In 2017, this income was $35,349 while interest expense on the Program bonds totaled $249,975. With no active investments and no plans to make future investments, it is likely that this trend will continue. ODFA intends to use its assets to the extent possible to meet its obligations. However, if ODFA is unable to meet its obligation at the maturity date, the obligation may be met by issuing general obligation bonds from the Credit Enhancement Reserve Fund.

Economic and Fiscal Impact

Economic and Fiscal Impact

The program was funded by one bond issuance of $9.9 million in 1996, maturing in 2031. To date, the costs of the program have included interest payments and investment fees paid by ODFA. The cost of these payments have exceeded the return on the program's investments, leading to a growing deficit as the program's net position. To date, these expenses have been incurred by ODFA. However, the program has the potential to have a more broad fiscal impact if this deficit continues. The bonds issued to fund the program can be repaid using the return on the program's investments, available funds in the ODFA's fund established for the program, or through Oklahoma's Credit Enhancement Reserve Fund (CERF). An Additional fiscal impact for the State would be created if the Program is unable to repay the bonds using the return from its investments and maintains a negative fund balance. In that case, the CERF will issue general obligation bonds in order to resolve the Program debt, and the Legislature would likely appropriate funds in order to pay the debt service on these general obligation bonds.

The benefits of the program to the State have been negligible based on available data. The only investment made by the Program with jobs and payroll information available is the 2007 investment of $1.2 million in the Oklahoma Seed Capital Fund. The Program's contribution to the fund accounted for about 20 percent of funding that year and the investments made by the fund have resulted in 40 jobs and $3.4 million in payroll according to the latest survey responses. If the Program's contribution is assumed to be responsible for 20 percent of those jobs, the cost per job of the investment is about $143,750.

Based on the available jobs and payroll data and the return on the Program's investments, it is likely the Program has had a negative return on investment for the State. However, without more comprehensive data regarding jobs, payroll and industries receiving funds it is not possible to accurately estimate the program's economic impact.

Incentive Benchmarking

Benchmarking

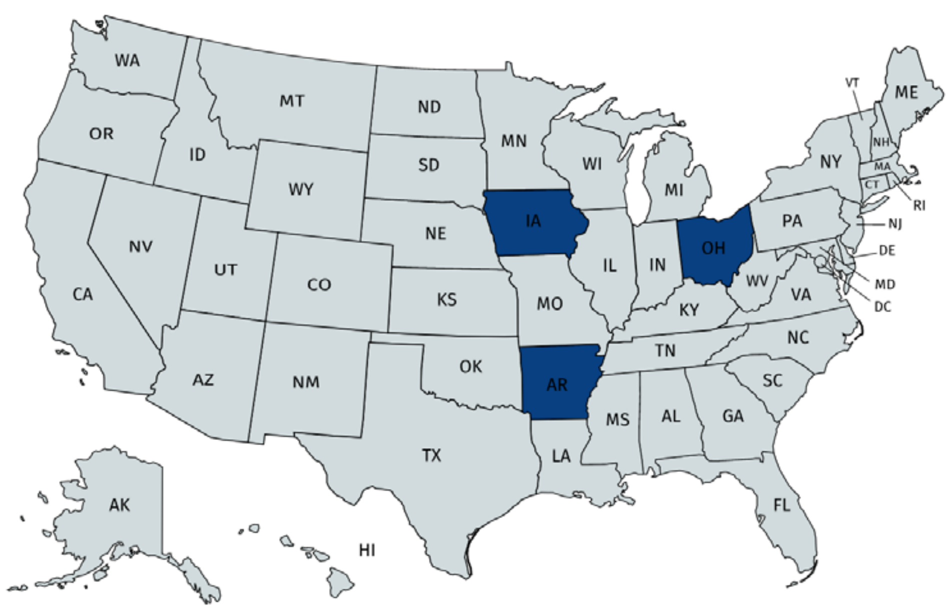
A detailed description of comparable state programs can be found in **Appendix A.**

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are 'perfect peers' – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.[2] These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentives typically begins with bordering states. This is generally the starting point, because proximity often leads states to compete for the same regional businesses or business/industry investments. Second, neighboring states often (but not always) have similar economic, demographic or political structures that lend themselves to comparison.

Benchmarking for this incentive program focuses on three states: Arkansas, Iowa, and Ohio. Many states offer some type of program to provide capital for start-up firms, but these states were selected due to a shared method of providing funds to an investment manager that then decides which companies to invest in. This is often referred to as a "fund of funds" strategy. While Oklahoma's Quality Jobs Investment Program does not define itself as a fund of funds, this is the most similar funding structure that is used in other states. Other important characteristics of these programs are described below.

Figure 2: States Offering Comparable Programs



Arkansas' Institutional Fund (AIF) was established in 2001 to increase the availability of capital for companies relocating and expanding in Arkansas. Similar to Oklahoma's program, it is managed through Arkansas' Development Finance Authority (ADFA). The ADFA partnered with an investment management firm to carry out the program's objectives. The AIF's funding comes from a $70 million line of credit secured

[2] The primary instances of exactly alike state incentive programs occur when states choose to 'piggyback' onto federal programs.

by collateral comprised of $10 million from the ADFA's Bond Guaranty Reserve Account and $60 million from transferrable tax credits. The use of tax credits as part of the collateral is a major difference between this program and the Oklahoma Program.

A 2016 Arkansas legislative audit of the program reported a net position of -$7.6 million.

The **Iowa Fund of Funds** program was established in 2002. The program is similar to Oklahoma's, because it provides funding to investment firms that invest in Iowa companies. However, it differs from Oklahoma's program in that it is funded by a $60 million loan secured with transferrable state tax credits.

By 2012, the loan agreement funding the program was in danger of default, and $25.6 million in tax credits were sold to offset the debt. As a result, in 2013 the Legislature voted to wind down the program and prohibited the fund from making any new investments.

The **Ohio Capital Fund** is designed to increase the availability of capital for early stage Ohio companies. The program invests in venture capital funds based in Ohio. It is funded by over $150 million in bonds collateralized by refundable state tax credits.

The fund reports an overall gross return of 6.7 percent. However, in 2017, it used its refundable state tax credits for the first time in order to make interest and principal payments on bonds. The fund used $15.4 million in refundable credits in 2017 and is expected to use more in 2018.

These three comparable programs differ from Oklahoma's in structure but a common theme among them suggests that a consistent return on investments of this kind is difficult to achieve. Arkansas' program currently has a negative fund balance, similar to Oklahoma's, Iowa decided to end its program and sell tax credits to avoid default on debt associated with its program, while Ohio has been forced to use refundable tax credits in order to keep its program active.

Appendices

Appendix A: Comparable State Programs

Quality Jobs Investment Program			
State	**Program Name**	**Maximum Program Funding**	**Collateral**
Oklahoma	**Quality Jobs Investment Program**	**$40 million**	**Credit Enhancement Reserve Fund**
Arkansas	Arkansas Institutional Fund	$70 million	$60 million in tax credits, $10 in guaranteed funds from the state
Iowa	Fund of Funds	$60 million	Transferrable Tax Credits
Ohio	Ohio Capital Fund	$125 million	Refundable Tax Credits